

# PRU Global Basics Fund

## Review: Second quarter, 2010

**PRU Global Basics Fund** (the “Fund”) is organised as a feeder fund, which feeds into Sterling Class A shares of the M&G Investment Funds (1) – M&G Global Basics Fund (the “Underlying Fund”), domiciled in the United Kingdom. The investment manager of the M&G Global Basics Fund is the UK domiciled M&G Investment Management Limited (“M&G”).

### Overview<sup>1</sup>

The Fund lost 11.2% (bid-to-bid basis) in the three months to 30 June 2010, ahead of the 12.1% decline by the benchmark FTSE Global Basics Composite Index.

Stock selection in the consumer services, industrials and healthcare sectors made the greatest contributions to Underlying Fund returns, while stock selection in basic materials was the main detractor. The Underlying Fund’s holdings in more defensive areas proved most resilient against the backdrop of sharp falls in global stockmarkets.

The Underlying Fund remained well diversified across asset-rich companies representing several themes along the ‘curve of economic development’, ranging from infrastructure growth in Asia to rising wealth and changing consumer spending patterns across emerging markets. The second quarter proved to be a period of heightened portfolio activity as fund manager of the Underlying Fund, Graham French (“Graham”) continued to move the portfolio towards a more defensive position.

### Fund performance

Period	1 month	3 months	6 months	1 year	3 years*	Since Inception*
Offer-Bid	-8.0%	-15.6%	-13.7%	7.9%	-13.1%	-0.9%
Bid-Bid	-3.2%	-11.2%	-9.1%	13.5%	-11.6%	0.2%
Benchmark	-3.7%	-12.1%	-9.6%	8.7%	-10.2%	-0.1%

Source: Prudential Asset Management (Singapore) Limited and M&G Investment Management Limited. S\$; net income reinvested; Offer-bid includes 5% Initial Sales Charge. \*Annualised. Inception date: 18 Oct 2005.

Most major stockmarkets came under heavy selling pressure in the second quarter of 2010 after it emerged in April that Greece’s sovereign debt crisis was deeper than anticipated, fuelling fears of contagion across other peripheral Eurozone nations. Against this backdrop, European equity markets were the biggest detractors due to their exposure to the region’s debt crisis, while stockmarkets in Asia Pacific were slightly stronger overall, reflecting investors’ continued optimism about the outlook for growing economies in the region. Although all major sectors declined on a global basis, investors showed a preference for more defensive areas of the market, namely healthcare and telecommunications. Unsurprisingly, cyclical oil & gas and basic materials stocks were among the biggest losers.

Despite losing ground in absolute terms, the Underlying Fund outperformed its benchmark, thanks in part to moves taken to reduce the economic sensitivity in the portfolio through taking profits in some of the strongest performers over the past year.

### Largest positive contributors<sup>1</sup>

There was a broadly defensive theme among the best-performing stocks in the portfolio, reflecting investors’ growing risk aversion during the period. The leading positive contributors came from across a range of sectors, including consumer services, consumer goods, healthcare and industrials.

The holding in Singaporean beverages and property group Fraser & Neave built on last quarter’s strong performance, registering as this period’s largest contributor due to strength in its drinks business and continued growth in value of its Singapore property portfolio. Graham believes that the company will continue to benefit from its quality brand names and excellent distribution capabilities, not just in beer, but also in soft drinks and dairy products. UK-based, but globally diversified, personal care products manufacturer PZ Cussons also added value, enjoying robust growth and strong cash generation across its markets.

Elsewhere, luxury hotel group Hong Kong & Shanghai Hotels, US coffee chain Starbucks and Yum! Brands (owner of KFC and Pizza Hut) were helped by expectations that changing consumer tastes and spending patterns in emerging markets will continue to support those firms well-positioned for long-term growth in these markets.

### **Largest negative contributors<sup>1</sup>**

The Underlying Fund's holdings in the basic materials sector generally made a negative contribution to performance. The strong sector rally from the market lows in early 2009 came to a halt in the second quarter, with many mining companies losing ground on the back of sharp declines in prices for metals and minerals as investors fretted about the deteriorating outlook for global growth. Sentiment towards the sector was exacerbated by concerns over a possible Australian mining tax, which pointed towards a tougher environment for the mining sector in the future.

UK-listed platinum miner Lonmin, Australian coal & iron ore producer Aquila Resources and French nickel & manganese group Eramet were among those stocks that declined in value. Graham has been reducing the Underlying Fund's exposure to the mining sector since the beginning of the year on valuation grounds and due to his more cautious outlook for the global economy. However, the remaining positions represent his continued confidence in a number of well-managed raw material producers whose world-class assets and long-term growth prospects he believes substantially outweigh current shorter-term concerns. Other cyclical holdings that succumbed to concerns regarding the outlook for industrial activity were Australian scrap metal recycler Sims Metal Management and Austrian-listed but global construction materials business Wienerberger.

### **Portfolio activity<sup>1</sup>**

Underlying Fund strategy continued to involve a shift up the 'curve of economic development' into a range of companies that the Underlying Fund manager believes are well positioned to benefit from powerful cultural and demographic shifts taking place in the global economy. These include the long-term growth of infrastructural development in industrialising economies such as China and India, and the rising wealth of their increasingly urbanised populations.

Graham has been positioning the Underlying Fund increasingly defensively in recent months through adding exposure to well established, cash-generative international consumer staples businesses. A new position was established in Nestlé, the globally diversified Swiss-based food manufacturer that is benefiting from the rising wealth and changing consumer spending patterns across the emerging markets. Graham also initiated a new position in Heinz, the manufacturer of consumer products including condiments, sauces, frozen foods and baby food. Graham believes that Heinz is an undervalued franchise that has changed dramatically in recent years to become a far more focused business with a portfolio of profitable brands and impressive distribution capabilities. Furthermore, Heinz has established a position as a leader in key emerging markets, including China. For similar reasons, Graham also added to the Underlying Fund's stakes in personal care products business PZ Cussons and leading security services provider G4S, both resilient, cash-generative UK-listed businesses but both genuinely international businesses whose potential for growth is being overlooked by investors.

As part of ongoing efforts to reduce the Underlying Fund's exposure to more cyclical parts of the market, Graham took advantage of share price strength to complete the sale of the position in Franco-German aerospace and defence business European Aeronautic Defence & Space (EADS), a long-term holding in the portfolio, as well as US-based dental products supplier Dentsply International following a period of strong returns.

In terms of the Underlying Fund's resources-related holdings, following a period of very strong performance within the basic materials sector that has left valuations more stretched than a year ago, Graham believes that a more selective approach is necessary. With this in mind, following last quarter's sale of BHP Billiton, Graham also exited from positions in US metal recycler Schnitzer Steel and US industrial minerals processor Minerals Technologies, while making significant reductions to UK platinum processor Johnson Matthey and French chemicals firm Arkema.

Some of the proceeds were reinvested into a combination of new mining holdings, including Turkish gold producer Anatolia Minerals and South American precious metals group Hochschild Mining, and existing holdings such as the recently established position in Aquila Resources, an attractively valued Australian iron ore and coal producer, and Noble Group, the Singapore-listed commodities provider. These purchases reflect Graham's view that, in spite of the sharp rebound in share prices, there remain a number of

attractively valued investment opportunities in the mining sector.

Elsewhere, holdings in US wine business Constellation Brands (concerns regarding the structure of the global wine industry) and UK defence technology business Qinetiq (fears over US/UK budget cuts) were among those stocks that Graham removed from the portfolio.

### Sector allocation

	Mar-10 (%)	Jun-10 (%)	Change (%)
Basic Materials	30.9	26.9	-4.0
Consumer Goods	27.6	24.5	-3.1
Industrials	19.0	20.2	+1.2
Consumer Services	8.1	9.1	+1.0
Oil & Gas	4.6	4.5	-0.1
Healthcare	4.1	3.6	-0.5
Financials	1.8	2.2	+0.4
Cash	4.0	9.0	+5.0

Source: M&G Investment Management Limited, 30 June 2010

From a sector perspective, basic materials, consumer goods and industrials continue to make up the major proportion of the Underlying Fund. The main shifts in sector weightings during the quarter were significant reductions in basic materials and consumer goods and a smaller increase in consumer services.

As a result of taking profits from a number of the Underlying Fund's strongest performers, the Underlying Fund's cash level rose to 9.0% at quarter end, a larger position than normal partly reflecting Graham's more cautious outlook for the market in light of ongoing uncertainty and hence volatility. The cash position will be reinvested as and when the right investment opportunities present themselves at the right valuations.

### Country allocation

	Mar-10 (%)	Jun-10 (%)	Change (%)
North America	27.8	24.2	-3.6
Europe (excluding UK)	22.7	18.8	-3.9
UK	19.2	18.0	-1.2
Australia	12.0	12.8	+0.8
Rest of World*	14.3	17.2	+2.9

\* Rest of World: Dubai, Hong Kong, Malaysia, Singapore and Russia.

Source: M&G Investment Management Limited, 30 June 2010

From a thematic perspective, Graham remains cautious but optimistic on the prospects for the world's developing economies, due largely to the impact that seismic structural and demographic shifts are having on the outlook for consumer spending on a wide range of 'basic' goods and services. This positive view on the structural dynamics supporting economic growth and rising wealth in emerging markets does not, however, result in a high weighting in emerging market-listed stocks.

As a valuation-focused Underlying Fund manager, Graham continues to be wary of overpaying for even the most compelling long-term story. Despite a small number of emerging market holdings coming into the Underlying Fund during the past 12 months, the Underlying Fund continues to have limited direct exposure to emerging market-listed stocks. Less than 15% of the portfolio was invested in companies listed in Asia ex-Japan, Latin America and EMEA at the end of the quarter, and most of these holdings were in the 'developed' Singapore and Hong Kong markets. Graham prefers, in general, to invest in Western companies whose exposure to the structural trends taking place in faster-growing developing markets remains significantly under-appreciated.

## Outlook<sup>1</sup>

Concerns about global growth have put equity valuations under renewed pressure, and Underlying Fund manager, Graham remains cautious in his outlook for the economy and financial markets, resulting in a relatively cautious positioning on the Underlying Fund. Nevertheless, he believes strongly that an indirect, stock-specific approach to investing in faster-growing parts of the world still offers exceptional opportunities for long-term investors. A range of countries throughout Asia, Latin America, the Middle East and Africa are going through a multi-decade revolution as economic power continues to shift from the more developed West to the developing East. Investment in infrastructure projects such as roads, hospitals and housing is driving demand for commodities, creating jobs and putting money in people's pockets. The rise in household income is helping to establish an increasingly affluent middle class whose consumers are willing to spend more to improve their quality of life.

Companies that understand this shift and are positioning themselves accordingly should be the winners over the next decade and beyond. However compelling the thematic drivers, though, a focus on company fundamentals remains the crucial factor when considering potential investments Undervalued assets, returns-focused management teams and strong adherence to corporate governance practices are pre-requisites for companies held on the Underlying Fund. Graham believes that by consistently applying this approach the fund will continue to generate superior long-term performance for its investors, irrespective of shorter-term swings in investor sentiment.

<sup>1</sup> Source: M&G Investment Management Limited

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